

Bankruptcy Trustees Not Entitled to Injunctive Relief That Would Give Them Priority to D&O Policy Proceeds

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The United States Bankruptcy Court for the District of Massachusetts has denied injunctive relief requested by two bankruptcy trustees seeking to stay the prosecution and settlement of shareholder actions proceeding against various former officers and directors of a bankrupt corporation. *In re Enivid*, 2007 WL 806627 (Bankr. D. Mass. Mar. 16, 2007). The court ruled that such relief was not warranted because the insured directors and officers were not debtors and the underlying securities plaintiffs were asserting claims against those insureds that were different from those advanced against them by the trustees. The court then approved a joint motion filed by the insured directors and officers and securities plaintiffs seeking to use D&O policy proceeds to fund the settlement reached in the shareholder actions.

The Liquidating Trustees of two liquidation trusts (the "Plan Trustees") filed motions for a preliminary injunction, seeking to stay several shareholder class actions filed against the directors and officers of a bankrupt corporation for violations of securities law until the trustees' breach-of-fiduciary-duty actions against those individuals were adjudicated or settled. The shareholder plaintiffs had reached a settlement agreement under which certain D&O policies would fund the settlement on the condition that the bankruptcy court would approve this use of the policy proceeds.

The Plan Trustees argued that the Bankruptcy Code's priority distribution scheme requires a distribution to creditors before shareholders. According to the Plan Trustees, the efforts to fund the securities settlement with the D&O insurance proceeds was an attempt to evade "the policies of the Bankruptcy Code and state law by racing the Trustees to the courthouse to claim assets that can and should be used to pay creditors." Further, they contended that the settlement would limit the administration of the two bankruptcy estates because the use of proceeds for the settlement would diminish the proceeds later available for any recoveries the Plan Trustees might obtain. Accordingly, the Plan Trustees requested that the Bankruptcy Court stay the shareholder actions pursuant to 11 U.S.C. § 105(a).

In response, the shareholder plaintiffs argued that the Plan Trustees' arguments were speculative, as the trustees had not obtained any judgment or settlement with the individual insureds. They also argued that the

insurance policy proceeds, as opposed to the policies themselves, were not property of the bankruptcy estate, and the "mere existence of potential indemnification coverage" did not transform policy proceeds into estate property. Further, they contended that because they sought recovery as shareholders against non-debtors rather than as creditors, the priorities under the Bankruptcy Code were inapplicable.

The court denied the requested injunctive relief. Focusing on the fact that the individual defendants were not debtors and the fact that the shareholder claims were distinct from the claims of the Plan Trustees, the court concluded that the Plan Trustees had failed to demonstrate a "legitimate reason" that their claims should have a higher priority than those of the securities plaintiffs. The court stated that "the [shareholder plaintiffs] are not bringing any litigation as creditors, and their damages, if any, will not be reduced by amounts they would receive for claims filed in the bankruptcy case." According to the court, to allow the proposed injunctive relief would "constitute a determination that the Plan Trustees' claims for breach of fiduciary duties or care and loyalty take precedence over the claims and settlements under federal securities laws. There is simply no basis in the Bankruptcy Code or other applicable law for such an order." Therefore, the court denied the Plan Trustees' motion and approved the joint motion seeking approval of the proposed securities settlement.